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In the Supreme Court of the United States

OCTOBER TERM, 1934

No. 582

GUY T. HELVERING, COMMISSIONER OF INTERNAL REVENUE, petitioner

v.

JAMES L. RANKIN, EXECUTOR OF THE ESTATE OF RICHARD B. TURNER, deceased

ON A WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE THIRD CIRCUIT

BRIEF FOR THE PETITIONER

OPINIONS BELOW

The findings of fact and opinion of the Board of Tax Appeals (R. 8–11) are reported in 26 B. T. A. 1204. The opinion of the Circuit Court of Appeals (R. 25–27) is reported in 73 F. (2d) 9.

JURISDICTION

The judgment of the Circuit Court of Appeals reversing the Board of Tax Appeals was entered

September 18, 1934. (R. 28.) The petition for a writ of certiorari was filed December 15, 1934, and was granted February 4, 1935. (R. 29.) The jurisdiction of this Court rests on Section 240 (a) of the Judicial Code, as amended by the Act of February 13, 1925.

QUESTIONS PRESENTED

1. Whether shares of stock held on margin are capable of identification so that a taxpayer selling part of his holdings may select, as his basis for determinitg gain or loss, the cost of any particular lot.

2. Whether Article 58, Regulations 74, is valid.

STATUTE AND REGULATIONS INVOLVED

Revenue Act of 1928, c. 852, 45 Stat. 791, 815, 816, 818:

> SEC. 111. DETERMINATION OF AMOUNT OF GAIN OR LOSS.
>
> (a) *Computation of gain or loss.*—Except as hereinafter provided in this section, the gain from the sale or other disposition of property shall be the excess of the amount realized therefrom over the basis provided in section 113, and the loss shall be the excess of such basis over the amount realized.
>
> * * * * *
>
> SEC. 112. RECOGNITION OF GAIN OF LOSS.
>
> (a) *General rule.*—Upon the sale or exchange of property the entire amount of the gain or loss, determined under section 111, shall be recognized, * * *.

SEC. 113. BASIS FOR DETERMINING GAIN OR LOSS.

(a) *Property acquired after February 28, 1913.*—The basis for determining the gain or loss from the sale or other disposition of property acquired after February 28, 1913, shall be the cost of such property; * * *.

Treasury Regulations 74:

ART. 58. *Sale of stock and rights.*—When shares of stock in a corporation are sold from lots purchased at different dates and at different prices and the identity of the lots cannot be determined, the stock sold shall be charged against the earliest purchases of such stock. * * *

STATEMENT

This is a proceeding for the redetermination of a deficiency in income taxes for the year 1928 in the sum of $11,173.05, asserted against one Richard B. Turner, who died in 1932, during the pendency of these proceedings, James L. Rankin, his executor, being substituted. (R. 6–7, 22–23.) The facts as found by the Board of Tax Appeals may be summarized as follows (R. 8–10):

Early in 1926, Turner (hereinafter called the taxpayer) purchased on marginal account with a Philadelphia broker 1,200 shares of United Gas Improvement Company stock. For nearly two years he had no further marginal transactions. At the beginning of 1928 his marginal account was long 1,500 shares of U. G. I., the additional 300

shares representing a 25 percent stock dividend credited to him late in 1926.

In 1928 the taxpayer began playing the market. Among many marginal transactions he bought 1,000 shares of U. G. I., and at one time sold 300 shares, at another 500 shares, and at still another 500 shares of that stock. By the end of 1928 (the tax year) the taxpayer's account was long 1,200 shares of U. G. I., the same number as he had bought in 1926.

The taxpayer always intended to retain the ownership on margin of 1,200 shares of U. G. I., since he had faith in the company and desired to hold them in lieu of certain bonds which he had received from the estate of his father. In giving orders to his broker to sell the 1,300 shares in 1928 he did not specify any particular shares to be sold, but an employee of the broker understood that the taxpayer desired to retain 1,200 shares to take the place of the bonds which he had received from his father. The taxpayer had made it plain to his associates that the 1,200 shares were in the nature of a permanent commitment on his part.

In computing the gain from the sale of the 1,300 shares in 1928 the Commissioner in accordance with Article 58 of Regulations 74, *supra,* applied the sales against the first purchases of the stock. The Board of Tax Appeals sustained this action (R. 10–11), but the Circuit Court of Appeals reversed, holding that Turner's communication to

his broker of his intention to hold the 1,200 shares first purchased as an investment was in effect an order to his broker not to sell those shares. The court decided that these instructions were in effect an identification of the shares later sold as those last purchased. (R. 26–27.)

SPECIFICATION OF ERRORS TO BE URGED

The Circuit Court of Appeals erred:

1. In holding that, while certificates of stock cannot be identified by a holder on margin, nevertheless shares of stock so held are capable of identification.

2. In holding that the communication to the stockbroker of an intention to hold the first shares purchased on margin was an identification of the shares sold within the meaning of Article 58, Regulations 74.

3. In holding that Article 58, Regulations 74, had no application to this case.

4. In reversing the Board of Tax Appeals.

SUMMARY OF ARGUMENT

I

Shares of stock as such have no earmark which distinguishes one share from another. It is only by tracing shares through identifiable certificates or similar evidences of ownership that one lot of stock can be distinguished from another. But in a marginal transaction the purchases and sales are

not represented by identifiable certificates and it is usually impossible for either the broker or the custom to identify the stock sold. Identification was impossible in this case. It was, therefore, proper for the Commissioner to apply the sales against the earliest purchases in accordance with Article 58, Regulations 74, *supra*.

The taxpayer's direction to his broker to sell the last shares purchased did not identify the stock sold. Mere intent to sell certain stock is not an identification of what was sold. Nor does a declaration of that intent amount to identification. It follows that a mere communication of intent to the broker, where the broker himself cannot identify, is likewise no identification.

II

The regulation does not deprive the taxpayer of due process of law. It is reasonable and necessary. Similar rules have been applied by the courts in other cases and are frequently found in the common law and in Federal statutes. It did not deprive the taxpayer of the right to submit all the facts bearing on the issue. The rule here has been approved by the court below and by all the courts that have had occasion to pass on it. It has also been applied by the Board of Tax Appeals in a number of cases. The presumption is in favor of its validity.

Aside from the regulation, the burden was upon the taxpayer to show the cost of what was sold.

This he did not and could not do. The impossibility of proving a material fact simply leaves him with an unenforceable claim.

ARGUMENT

I

THE TAXPAYER FAILED TO IDENTIFY THE VARIOUS LOTS OF STOCK PURCHASED BY HIM ON MARGIN, HENCE IT WAS PROPER TO CHARGE THE FIRST SALES AGAINST THE FIRST PURCHASES

In 1926 the taxpayer acquired, in various lots, 1,500 shares of U. G. I. stock at a total cost of $117,202.50. In 1928 (the taxable year), he bought an additional 1,000 shares of the same stock for $143,225, and in the same year he sold 1,300 shares of this stock for $192,599. All of these transactions were made through a broker on margin.

Section 112 of the Revenue Act of 1928 (*supra*, p. 2) provides that upon a sale of property the entire amount of the gain shall be recognized. Section 111 provides that the gain from such sale shall be the excess of the amount realized over the basis provided in Section 113. Section 113 (*supra*, p. 3) says that the basis of property acquired after February 28, 1913, shall be the cost. The parties here agree that these statutes are applicable; that shares of stock are identifiable, and for tax purposes are regarded as specific property; that the statutes referred to do not permit the merging or averaging of the cost of stock acquired at various prices over a period, but that each lot of stock pur-

chased carries with it its own cost which must be applied against the selling price of that particular lot in order to determine the proper gain or loss on that particular transaction. See *Skinner* v. *Eaton*, 45 F. (2d) 568, 569–570 (C. C. A. 2d) affirming 34 F. (2d) 575, certiorari denied, 283 U. S. 837; *Towne* v. *McElligott*, 274 Fed. 960 (S. D. N. Y.).

In this case the selling price of the stock in question is not disputed. The controversy is over the proper cost basis. The taxpayer contends, and the court below held, that the taxpayer identified the stock sold as the stock last acquired by him and that the cost of such last acquired stock furnished the proper basis for computing the gain. It is the Commissioner's position, and was found by the Board of Tax Appeals, that the identity of the various lots of stock purchased had been lost and that it was therefore proper to use as the basis the cost of the first acquired stock in accordance with Article 58, Regulations 74 (*supra*, p. 3), which provides:

> When shares of stock in a corporation are sold from lots purchased at different dates and at different prices and the identity of the lots cannot be determined, the stock sold shall be charged against the earliest purchases of such stock. * * *[1]

[1] This regulation, commonly known as the "first in, first out" rule, has been in effect under all the Revenue Acts. Article 4, Paragraph 60, Regulations 33 (Revised), promulgated under the 1916 Act; Article 39, Regulations 45, 62, 65 and 69, promulgated under the Revenue Acts of 1918, 1921,

Since the purchases and sale here were all on margin, the real question in the case is whether marginal stock can be identified and whether the taxpayer did in fact identify the marginal stock sold in 1928.

The mechanics of a marginal transaction is a matter of common knowledge. Each customer is merely charged on the broker's books with the number of shares ordered. No entry is made on the books of the serial numbers of the certificates. The certificates are not issued in the name of the customer, but in the name of the broker or street names. The broker makes no allocation of the particular certificates to any particular client, nor are the certificates earmarked in any way. All stock of the same kind is commingled and held by the broker for the common benefit of all dealing in that particular stock. Marginal stock held by the broker is, therefore, a "fungible mass." The situation is similar in nature to the case of a grain elevator. A depositor may have a property in the

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1924 and 1926, respectively; and Article 58 of Regulations 74 and 77, promulgated under the Revenue Acts of 1928 and 1932, respectively. It has received legislative and judicial approval. *Skinner* v. *Eaton*, *supra*; *Howbert* v. *Penrose*, 38 F. (2d) 577 (C. C. A. 10th). The court below has sustained and applied the rule in similar cases. *Snyder* v. *Commissioner*, 54 F. (2d) 57; *Snyder* v. *Commissioner*, decided September 18, 1934, 73 F. (2d) 5; *Horner* v. *Commissioner*, 72 F. (2d) 407; *Commissioner* v. *Merchants' & Mfrs.' F. Ins. Co.*, 72 F. (2d) 408.

grain therein although the keeper is at liberty to mix his own and other grain with the deposit and empty and refill the receptacle many times before making good his receipt to the depositor concerned. See *Sexton* v. *Kessler,* 225 U. S. 90, 97–98. So particular shares held on margin are not identifiable, because the common fund is the common property of all dealing in that stock and this common fund is in a constant state of flux. See *Snyder* v. *Commissioner,* 54 F. (2d) 57 (C. C. A. 3d), *supra.*

This case is typical. The taxpayer never received any certificates. No certificates were issued in his name. The taxpayer "just gave an order to the broker buy or to sell so many shares and received the notice the following day that so many shares were bought or sold." (R. 18.) No certificates were earmarked for the taxpayer on the broker's books of account and the broker could not advise the taxpayer of any specific certificates that were purchased for him in 1926 and 1928. (R. 10.) The broker "cleared through a clearing house and always kept or had certificates for exactly the number of shares that all of their customers were long but they could not say that certain certificates or certain numbers were the decedent's." (R. 18.) Under these circumstances, we submit, the Commissioner properly applied the regulation referred to above. It was designed to meet just such a situation as this and provides for a cost basis in these

transactions where identification is impossible.[2] See cases cited in footnote 1, *supra*. See also *Cole v. Helburn*, 4 F. Supp. 230 (W. D. Ky.); *Towne* v. *McElligott*, 274 Fed. 960, *supra*.

Although approving of the regulation, the court below held that it had no application here because the taxpayer identified the shares sold as the latest shares purchased. (R. 26–27.) The taxpayer's first purchases of stock were made with funds derived from his father's estate. He was sentimental about keeping the first 1,200 shares purchased as an inheritance from his father and intended to retain these shares as an investment and sell in speculation the more recently acquired stock. In giving orders to his brokers to sell 1,300 shares of stock in 1928, the taxpayer did not specify any particular shares to be sold, but an employee of the broker understood that the taxpayer desired to retain 1,200 shares to take the place of the funds which he had received from his father. The taxpayer also had made it plain to his associates that the 1,200 shares were in the nature of a permanent commitment on his part. (R. 10–17.) The court below held that taxpayer's communication to his

[2] The statement that identification is impossible in marginal transactions, while generally true, may be subject to certain exceptions, e. g., where each purchase on margin is made through a different broker. In such event the sale by one broker of all the stock previously purchased by him for the customer might operate to identify the lot sold. Such is not the case here.

broker of his intention to hold the 1,200 shares first purchased was in effect an order not to sell those shares and that this communication of intention was identification sufficient to take the case out of the rule (R. 26–27), despite the fact that the broker could not say what shares had been sold (R. 18). Thus the court allows a mere declaration of intention to take the place of the actual identification required by the regulation.

We submit the taxpayer's intention is without bearing on the question here. It is apparent from the language of the regulation that actual identification and not mere intent is the controlling factor. Effect must be given to what was actually done rather than to what the parties now say they intended to do. *Weiss* v. *Stearn*, 265 U. S. 242; *Clemmons* v. *Commissioner*, 54 F. (2d) 209 (C. C. A. 5th). That intent is not controlling in a case of this kind was recognized in *Skinner* v. *Eaton*, *supra*, where the Circuit Court of Appeals for the Second Circuit said (p. 570):

> The declarations of a taxpayer as to his intention to sell the more recently purchased stock and to retain his original holdings, made orally, are insufficient to change the result. They indicate merely a purpose which he may not have adhered to. *They in no way marked the particular shares of stock here under consideration, the identity of which the trial judge has found to have been lost.* (Italics supplied.)

And so in this case. The taxpayer merely gave orders to his broker to sell 1,300 shares of U. G. I. stock without specifying what shares to sell. The broker could not determine which shares were actually sold. (R. 18.) The fact that the taxpayer informed an employee of the broker of his intention to retain the first purchases is insufficient to change the result. It indicates merely a purpose which taxpayer may not have adhered to. It in no way marked the particular shares of stock under consideration, the identity of which the Board of Tax Appeals has found to have been lost.

Even in *Howbert* v. *Penrose, supra,* upon which the court below places so much reliance, it was said (p. 578):

> So it is of the question of intent of the seller, a point much labored at the trial and here; it is some evidence as to what was done, but not conclusive. The ultimate question is, What was done? * * *

What was done in this case is not disputed. In giving orders to his broker to sell 1,300 shares in 1928 the taxpayer did not specify any particular shares to be sold (R. 9, 18), and in executing the order the broker did not and could not identify the shares actually sold (R. 18).

The Board of Tax Appeals in a long line of cases has applied the regulation to facts similar to the facts at hand and held that intention is not controlling. *Leng* v. *Commissioner,* 22 B. T. A. 149;

Jenks v. *Commissioner*, 22 B. T. A. 910; *Hedrick* v. *Commissioner*, 24 B. T. A. 444; *Stryker* v. *Commissioner*, 21 B. T. A. 561; *Scanlon* v. *Commissioner*, 21 B. T. A. 1120; *Cleveland Trust Co.* v. *Commissioner*, 24 B. T. A. 132; *Finlay* v. *Commissioner*, 17 B. T. A. 828; *Mickler Holding Co.* v. *Commissioner*, 29 B. T. A. 300; *Kelchner* v. *Commissioner*, 31 B. T. A. 262; *Seelye* v. *Commissioner*, 29 B. T. A. 695.

In the first *Snyder* case, *supra* (54 F. (2d) 57, 59), the court below held that "a mental condition * * * falls short of evidential 'identification'." In *Commissioner* v. *Merchants' & Mfrs.' F. Ins. Co.*, *supra* (72 F. (2d) 408), and in *Horner* v. *Commissioner*, *supra* (72 F. (2d) 407), it held that intent was not controlling. In the second *Snyder* case, *supra* (73 F. (2d) 5),[3] the court again held that mere intent "without something more" was not sufficient to take the case out of the rule. And in this case the court once again held that mere intention standing alone was not sufficient to identify the shares sold. The court also held that even repeated declarations of that intention to the taxpayer's associates was not enough (R. 26), citing with approval *Skinner* v. *Eaton*, *supra*. But the court, in endeavoring to reconcile its earlier decisions, held that here there was "something more,"

[3] The second *Snyder* case was decided on the same day the instant case was decided and is now pending in this Court, No. 663, present term.

namely, the communication of the intent to the broker, which was sufficient to take the case out of the rule. However, we submit that where it is impossible even for the broker to identify (R. 18), a declaration of intent made to the broker is not different from a similar declaration made to the taxpayer's associates, as in the *Skimmer* case, *supra*. Since the broker cannot identify, it is not apparent how the communication of the taxpayer's intention to the broker can add anything to the intention itself.[4]

The court below sought to make a distinction between a sale of shares and a sale of certificates. See also second *Snyder* case, *supra*. It recognizes that in marginal transactions certificates cannot be identified, but holds that shares, as distinguished from certificates, are capable of identification. This so-called distinction does not exist in a case of this kind. It is true, as the court below stated, that shares of stock and certificates of stock are not one and the same; that a share of stock is the interest of the stockholder in the corporation, is of itself property and is the subject of conversion, while the certificate is the symbol or paper evidence of the ownership of the shares and is not the stock itself. It is also true that in marginal trading the

[4] The taxpayer in *Snyder* v. *Commissioner*, No. 663, agrees that since marginal stock is inextricably mixed, a direction to the broker to sell the last acquired stock first is merely evidence of intent and adds nothing of substance to a declaration of intent. See *Snyder* petition, p. 20.

rapid shifting of certificates between brokers may cause the certificates to go in one direction and the shares in another. But this merely serves to show the impossibility of identifying shares in a case of this kind.

Shares of stock as such have "no earmark which distinguishes one share from another", just as with grain of a uniform quality, one bushel is of the same kind and value as another. *Richardson* v. *Shaw,* 209 U. S. 365, 379; *Duncan* v. *Johnston & Co.,* 3 F. (2d) 422 (C. C. A. 6th), certiorari denied, 267 U. S. 600; *Hubbell* v. *Drexel & Co.,* 11 Fed. 115; *Caswell* v. *Putnam,* 120 N. Y. 153, 157; *Skowhegan Bank* v. *Cutler,* 52 Me. 509, 517. Shares of stock are intangible and rest in abstract legal contemplation. *Burrall* v. *Bushwick Railroad Co.,* 75 N. Y. 211, 217.

Since one share of stock is identical with every other share of the same issue, shares as such have no identity. But the law does recognize an identity in every share where such shares can be traced in some way, either on the books of the corporation or by certificates or by some other evidence of ~~indebtedness~~ ownership. As stated by Judge L. Hand in *Towne* v. *McElligott, supra* (274 Fed. 960, 963):

> The law may, and in fact does, recognize an identity in every share, which can indeed be traced upon the books of the company, at least until certificates are consolidated, and later subdivided. The purchase of a number

> of shares can be earmarked by the certificate, and it is an enormous convenience to keep the purchases separate. * * *

The usual method of identification is, of course, by tracing the shares through certificates. Shares of stock as such being incapable of actual delivery, some evidence of ownership must be used for purposes of symbolical delivery. And while title may be transferred in other ways, the usual transfer is effected through certificates which are documentary evidence of title. Ordinarily no one can get the benefit of ownership of stock except through and by means of certificates. *Disconto-Gesellschaft* v. *U. S. Steel Co.*, 267 U. S. 22, 28. For these and other reasons the law frequently identifies a share of stock by and with its physical representative. Thus stock may acquire a *situs* for the purpose of taxation where the certificates are found. *Burnet* v. *Brooks*, 288 U. S. 378; *DeGanay* v. *Lederer*, 250 U. S. 376; *First Nat. Bank of Boston* v. *Commissioner*, 63 F. (2d) 685 (C. C. A. 1st). A wrongful use of an endorsed certificate may be treated as a conversion of the stock itself. *McAllister* v. *Kuhn*, 96 U. S. 87, 89. A banker lending money to a person for his private use, on the security of stocks, the certificates of which show that he holds them as trustee for another, is chargeable, as party to the breach of trust, for the value of the trust property converted. *Duncan* v. *Jaudon*, 15 Wall. 165; *National Bank* v. *Insurance*

Co., 104 U. S. 54, 63. Where stock pledged as collateral can be identified by numbered certificates, the pledgor is entitled to have a return of his identical shares as evidenced by such certificates, and may treat a sale by the pledgee of such stock as a conversion, although the pledgee has at all times a sufficient number of shares of the same stock to meet the pledge. *Allen* v. *Dubois*, 117 Mich. 115. And where stock is owned outright (that is, not on margin) gain or loss on its sale is to be based on the cost of certificates delivered rather than on the cost of the certificates which the seller intended to but did not deliver. *Commissioner v. Merchants' & Mfrs.' F. Ins. Co., supra; Cole* v. *Helburn, supra.* Cf. *Howbert* v. *Penrose, supra.*

The question of stock identification often arises in cases dealing with the bankruptcy or insolvency of stock brokers. To get any standing except as general creditors, customers trading with a bankrupt broker must identify the original assets or trace them into other specific funds which came into the trustee's hands. *National City Bank* v. *Hotchkiss*, 231 U. S. 50; *Schuyler* v. *Littlefield*, 232 U. S. 707; *St. Louis & S. F. R. R.* v. *Spiller*, 274 U. S. 304, 310; *In re Byrne*, 32 F. (2d) 189, 190 (C. C. A. 2d), certiorari denied, *sub nom. Mohr* v. *Bielaski*, 280 U. S. 557. But where the stock purchased is susceptible of identification, the customer's right thereto is superior to that of a general creditor. *Denton* v. *Gurnett & Co.*, 69 F. (2d) 750 (C. C. A. 1st). The courts generally hold that

stock can be identified by means of certificates and if the customer can trace his stock held by the broker by certificate numbers he is entitled to a return of that particular stock. *In re T. A. M'Intyre & Co.*, 181 Fed. 955, 958 (C. C. A. 2d); *In re Ennis*, 187 Fed. 728 (C. C. A. 2d); *In re J. F. Pierson, Jr., & Co.*, 225 Fed. 889 (S. D. N. Y.), affirmed, 233 Fed. 519 (C. C. A. 2d); *In re J. C. Wilson & Co.*, 252 Fed. 631, 653–654 (S. D. N. Y.). But where the certificates cannot be traced, the courts in order to do justice and equity must rely upon a presumption or fiction to take the place of actual identification. In such cases the "grain-in-the-bin" doctrine is accepted and the courts hold that there is sufficient identification of the stock held by the bankrupt estate if the broker's "box" contains certificates in excess of those claimed by the purchasers of those stocks, provided there are no other claimants to that stock. This identification is based on the presumption that the stock on hand was purchased by the broker to meet his obligations. The fact that the customer is unable to put his finger upon the identical stock certificates purchased for him, or that the certificates in the box may be others than those originally purchased, is considered unimportant, since a certificate for a number of shares represents precisely the same kind and value of property as another certificate for a like number and kind of shares in the same corporation, and the presumption is that if the

broker disposes of the certificates first acquired he replaces them with like certificates later in order to keep on hand at all times sufficient stock to meet his obligations. See *Richardson* v. *Shaw*, 209 U. S. 365, *supra*; *Gorman* v. *Littlefield*, 229 U. S. 19; *Duel* v. *Hollins*, 241 U. S. 523; *Sexton* v. *American Trust Co.*, 45 F. (2d) 372 (C. C. A. 8th). The rationale of these decisions is that if the bankrupt estate has enough of the particular stock to cover all customers who are long on the day of the failure, then the presumption that the broker intended to keep their stock on hand is sufficient identification of the stock as theirs. If, however, the stock on hand is not sufficient to satisfy all long customers, no such presumption arises. *In re J. F. Pierson, Jr., & Co., supra.*

Thus the courts realize that while shares of stock in and of themselves have no identity, they may be identified by and through certificates. And where the identity of the certificates is lost, reliance must be placed on some presumption. So it is here. For tax purposes, stock may be identified by means of certificates, but where the identity of the certificates is lost the need for a presumption such as the one contained in the regulation becomes apparent. Conceding that stock may be identified in other ways than by means of certificates, such as by entry on the stock books of the corporation or by some other identifying evidence of ownership, we submit such is not the case here. The taxpayer, trading on

margin, was not dealing in identifiable stock certificates, or in any other evidences of ownership. The broker's books were not kept in such a way as to preserve the identity of the various purchases. Each share purchased by the taxpayer was identical with every other share and neither the broker nor the taxpayer could say that the shares sold were actually the last shares acquired. Under these circumstances, we submit the Commissioner was entirely justified in applying the regulations and in matching the sale against the first purchases.

II

THE REGULATION IS VALID

The taxpayer argued below and will undoubtedly contend here that the regulation, if applicable, is invalid for the reason that it violates the due process clause of the Constitution. A similar argument is advanced by the petitioner in *Snyder* v. *Commissioner*, No. 663, present term. The contention is without merit.

Since the attack is on the ground that the due process clause is violated, the question is simply whether the regulation is reasonable (*Mobile, J. & K. C. R. R.* v. *Turnipseed*, 219 U. S. 35, 43), that is, whether it "is appropriate to the case." *Hagar* v. *Reclamation District No. 108*, 111 U. S. 701, 708. This must be determined by the circumstances. *Reaves* v. *Ainsworth*, 219 U. S. 296, 304. The

regulation is altogether reasonable under the circumstances and was held to be so by the court below.

The Constitution has granted broad powers of taxation to Congress. Congress in exercising that power has undertaken to tax gains derived from the sale of property and to measure such gain by comparing the selling price of the property with its cost. The burden is placed on the taxpayer in each instance to show the cost of that which he has sold. In case of stock sales this burden can usually be met by showing the cost of stock certificates delivered. But in marginal transactions, particularly in pyramiding operations such as those in the *Snyder* case, it is impossible for the taxpayer to identify.[5] In such cases the need for such a rule as this seems apparent. The interests of both taxpayers and the Government required the adoption of some rule prescribing the measure of the tax. Obviously one of three rules was available, either the "first-in, first-out" rule, or that of averaging the cost of all the stock acquired, or that of "last-in, first-out." Of the three, we submit the "first-in, first-out" is the fairest and most reasonable to both the Government and taxpayers. It operates to the advantage of taxpayers as often as it does to the advantage of the Government. The rule has been in effect for a

[5] Unless the court below is right that directions to the broker is sufficient identification, which we submit it is not. See also footnte 2, p. 11, *supra*.

number of years. It was in effect when the transactions here in question were entered into. The taxpayer bought and sold the stock under the admonition of the law that if he could not identify the stock sold, his gain would be measured in this way. He cannot, therefore, complain that he has been deprived of his property without due process. *Orient Insurance Co.* v. *Daggs,* 172 U. S. 557, 566. The due-process clause is but an admonition of fair dealing (*Cohan* v. *Commissioner,* 39 F. (2d) 540, 545 (C. C. A. 2d)), and considering the circumstances, we submit the regulation is entirely fair and reasonable.

The taxpayer contends that the regulation creates a conclusive presumption of fact that the shares sold were those first acquired and since it operates to deny him a fair opportunity to rebut it is void under *Heiner* v. *Donnan,* 285 U. S. 312; *Bailey* v. *Alabama,* 219 U. S. 219, 238; and *Manley* v. *Georgia,* 279 U. S. 1, 5–6. But those cases deal with rules of evidence and the rule here is not so much a rule of evidence as it is a rule of substantive law. The regulation is only applicable in those instances where the taxpayer cannot identify. It does not establish a conclusive presumption of fact, but merely provides a method of computing the gain or loss in those cases where the exact facts are incapable of proof. Under such circumstances, the courts recognize the value of a rule of this kind as an expedient for the ready solution of disputes. Rules of this kind, sometimes called "conclusive

presumptions", are in reality rules of substantive law and are frequently found in the common law and have for many years been included in statutes. Such rules are not true presumptions at all. Cf. 2 Chamberlayne on Evidence, Sections 1086, 1087, 1159, *et seq.;* 5 Wigmore on Evidence (2d Ed.), Section 2492.

Among the so-called "conclusive presumptions" are: A child under seven years of age is unable to form a criminal intent (*Allen* v. *United States,* 150 U. S. 551, 558); a male child under fourteen years of age cannot commit the crime of rape, and the related presumption as to the age of consent by a female (see *Holland* v. *State,* 161 Ga. 492); tax deeds are conclusive as to compliance with requirements of tax laws (*Callanan* v. *Hurley,* 93 U. S. 387, 390, 392); a deed registered twenty years or more under a Tennessee statute is registered on lawful authority (*Webb* v. *Den,* 17 How. 576); the imposition of liability on cities for damages by mob violence (*City of Chicago* v. *Sturges,* 222 U. S. 313); stockholders are conclusively presumed to be citizens of the State in which the corporation is domiciled (*Muller* v. *Dows,* 94 U. S. 444; *Louisville Railroad Co.* v. *Letson,* 2 How. 497).

The difficulties of proof justified imposing liability upon the initial carrier for loss or damage to goods shipped on a through bill of lading. *Atlantic Coast Line* v. *Riverside Mills,* 219 U. S. 186.

The so-called "conclusive presumptions" are frequently met in Federal tax laws. For example, Section 3207 of the Revised Statutes, as amended by Section 1127 of the Revenue Act of 1926, c. 27, 44 Stat. 9 (U. S. C. App., Title 26, Sec. 136), establishes a conclusive presumption as to the validity of assessment in suits in equity by prior lienors. In Section 31 (b) of the Revenue Act of 1916, added by Section 1211 of the Revenue Act of 1917, c. 63, 40 Stat. 300, and Section 201 (b), (d), and (e) of the Revenue Act of 1918 and corresponding sections of the subsequent Acts, we find the precise counterpart of the present regulation. Under these statutes dividends are conclusively presumed to have been paid out of certain specified profits. The courts have frequently applied and upheld these provisions despite their conclusive character. *Helvering* v. *Canfield,* 291 U. S. 163; *Douglas* v. *Edwards,* 298 Fed. 229 (C. C. A. 2d), reversed on other grounds, 269 U. S. 204; *Leland* v. *Commissioner,* 50 F. (2d) 523 (C. C. A. 1st), certiorari denied, 284 U. S. 656; *Harder* v. *Irwin,* 285 Fed. 402 (N. D. N. Y.); *Mason* v. *Routzahn,* 8 F. (2d) 56 (N. D. Ohio), reversed, 13 F. (2d) 702 (C. C. A. 6th), reversed, 275 U. S. 175.

Congress is the judge of the degree of necessity which calls forth the statute (*Everard's Breweries* v. *Day,* 265 U. S. 545, 559), whether the necessity arises because of the difficulty of proof, as in this case, the similarity of objects, or because experi-

ence has shown that the thing declared by the statute to be true is so often true that the administration of justice will best be served by not permitting it to be questioned in any case. Considered as a rule of substantive law, we submit the regulation is reasonable under the circumstances and appropriate to the nature of the case. In similar circumstances the rule has been applied aside from the regulation (*Towne* v. *McElligott, supra*), and in somewhat analogous situations the courts have applied a similar rule as being the most reasonable rule available. Thus, where a trustee has mingled the monies of several defrauded claimants and the fund is insufficient to satisfy them all, it is held that the first withdrawals are to be charged against the first deposits and the claimants are entitled to be paid in the inverse order in which their monies went into the account. See *Cunningham* v. *Brown,* 265 U. S. 1, 12; *Clayton's Case* (1816 Ch.), 1 Merivale 572; cf. *Hewitt* v. *Hayes,* 205 Mass. 356, 365. See also *Empire State Surety Co.* v. *Carroll County,* 194 Fed. 593, 604–605 (C. C. A. 8th). Likewise, there is the analogy to payment upon an open account, where the law has always allocated the earlier payments to the earlier debts, in the absence of a contrary intention. See *Towne* v. *McElligott, supra,* p. 963. Compare also the presumption invoked in bankrupt brokers cases referred to under Point I, *supra.*

And even considered as a rule of evidence rather than a rule of substantive law, the regulation is not unconstitutional. The court below in the *Snyder* case, No. 663, said the presumption was rebuttable. Perhaps it would be more accurate to say that it does not arise until identification is shown to be impossible. The taxpayer is given every opportunity to identify the shares he has sold and to prove his loss or gain accordingly. The regulation does not deny the taxpayer a fair opportunity to offer testimony as in *Bailey* v. *Alabama, supra,* and in *Manley* v. *Georgia, supra.* Nor does it constitute an attempt to enact into existence a fact which does not and cannot be made to exist in actuality, as in *Heiner* v. *Donnan, supra.* The regulation meets the test laid down in *Mobile, J. & K. C. R. R.* v. *Turnipseed,* 219 U. S. 35, where this Court said (p. 43):

> If a legislative provision not unreasonable in itself prescribing a rule of evidence, in either criminal or civil cases, does not shut out from the party affected a reasonable opportunity to submit to the jury in his defense *all of the facts bearing upon the issue,* there is no ground for holding that due process of law has been denied him. (Italics supplied.)

See also *Cockrill* v. *California,* 268 U. S. 258, 261; *Yee Hem* v. *United States,* 268 U. S. 178, 183–184. It is clear that the regulation did not shut off from the taxpayer a reasonable opportunity to submit

all the facts bearing upon the issue. Indeed the rule comes into operation only when the taxpayer is unable to prove the identity of the shares sold. It is not the regulations which deny the taxpayer the right to identify, but the very nature of marginal transactions, in which the taxpayer voluntarily engaged, that prevents the identification. The taxpayer's position, in substance, is that the presumption upon which the Commissioner acted must be changed in his case because the manner in which he operated makes it impossible for him to show that the fact presumed did not in fact exist. The real burden of taxpayer's complaint is not that he has been deprived of an opportunity to make a defense, but rather that he has no defense to offer, which in turn is due, not to the assailed regulation, but to the nature of the transaction in which he voluntarily engaged. And it is because of the very nature of the transaction which makes identification impossible, that a rule of this kind becomes necessary. The rule is reasonable under the circumstances. It is certainly the most convenient rule from an administrative standpoint. It operates to the taxpayer's advantage as much as to his disadvantage. Under it he is taxed only on what is true income. He can offer no better rule.

The rule has been sustained by the court below and has received the approval of all the courts that have had occasion to pass upon it. It has been applied by the Board of Tax Appeals in the long

line of cases referred to above. Since it has received Congressional approval, the presumption is in favor of its constitutional validity. It should not be set aside unless it clearly operates to deprive the taxpayer of due process of law. See *Hylton* v. *United States*, 3 Dall. 171, 174; *Legal Tender Cases*, 12 Wall. 457, 531; *Graves* v. *Minnesota*, 272 U. S. 425, 428; *Whitney* v. *California*, 274 U. S. 357, 371. We submit the regulation is valid.

Aside from the regulation, the tax asserted in this case should have been sustained. The Commissioner determined the gain measured by the cost of the first stock acquired by the taxpayer. The burden was on the taxpayer to show that this was wrong. But because of the very nature of the transaction, it was impossible for the taxpayer to do this. The rule in *Burnet* v. *Houston*, 283 U. S. 223, is applicable. There this Court said (p. 228):

> The impossibility of proving a material fact upon which the right to relief depends, simply leaves the claimant upon whom the burden rests with an unenforcible claim, a misfortune to be borne by him, as it must be borne in other cases, as the result of a failure of proof.

Since the taxpayer did not, and could not, show that the Commissioner's determination was erroneous, the decision of the Board of Tax Appeals was plainly correct.

CONCLUSION

The decision below should be reversed.

Respectfully submitted.

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